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Contract Costing Issues

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August 22, 2000

Policy Change Notice No. 00-108

Summary of Chapter Changes:

It is important that Procuring Contracting Officers (PCOs) and Program Managers be kept apprised of changes in Forward Pricing Rates.

To ensure Program Managers and PCOs are aware of rate changes and related program impacts, ACOs and DACOs administering major weapon program contracts must provide proposed and recommended Forward Pricing Rate information to the PCO and the DCMC Program integrator.

The DCMC Program Integrator will incorporate this information into the monthly Program Assessment Report, which is submitted to the program office.

Information should be provided whenever Forward Pricing Rates change or are **expected** to change.

Our Focus Today

Discussion Topics

- ⌞ Players (Contracting Officers' Roles)
- ⌞ Emphasis on Overhead Rates
- ⌞ Causes of changes in programs' cost profile
- ⌞ Illustration by Raytheon Corporate
Administrative Contracting Officer

Cognizant DCMA Contracting Officers

Corporation	CACO/DCE	<i>Pension, Insurance, HOE, Restructuring</i>
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Segment	DACO	<i>Overhead rates</i>
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Program	ACO???	<i>Your focus</i> <i>...but you might not have a</i> <i>"contracts" counterpart</i>
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Contract	ACO	<i>Pricing of assigned contracts (allocation/ allowability of estimated or incurred costs)</i>
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***As a PI, you have multiple
corporations, segments,
contracts...***

***...contracting structure in typical
CMO doesn't make your job easy***

Emphasis on Overhead Rates

First, some background...

Direct Cost--benefits a specific contract

Examples: manufacturing labor, material, travel, testing, program support

***Indirect Cost--benefits more than one contract
(or isn't worth charging direct)***

Examples: supervision of manufacturing labor, HOE, purchasing, low \$ material

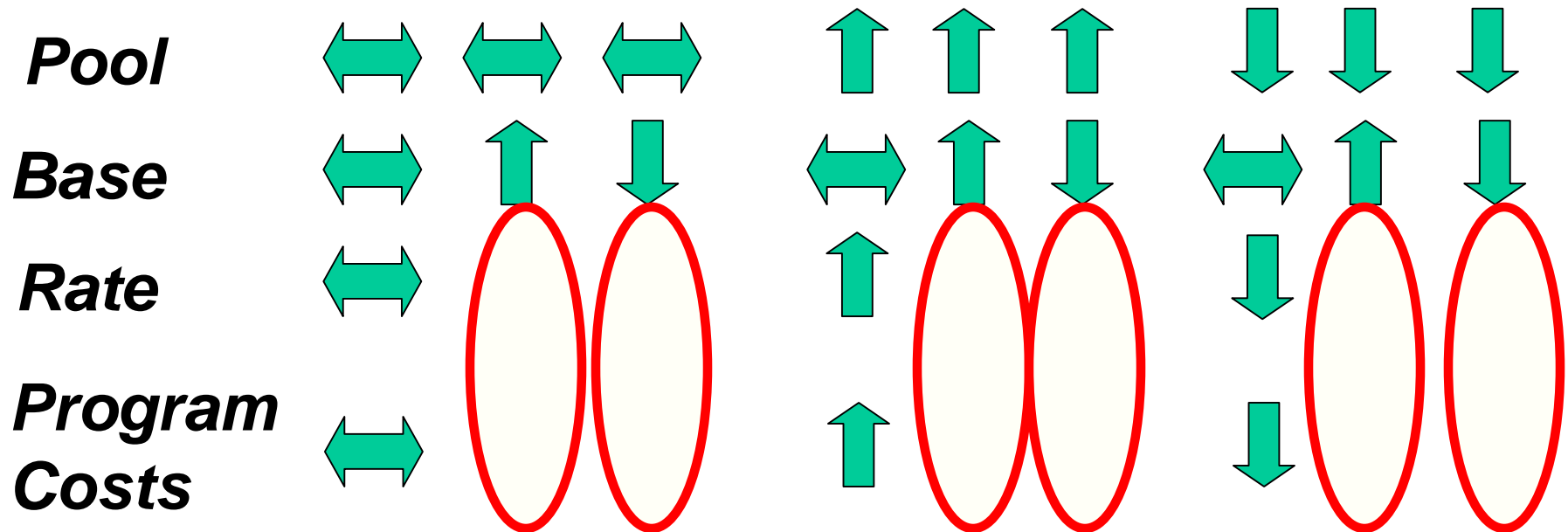
Overhead Rate--way of allocating indirect costs to contracts

Overhead Pool--collects similar indirect costs

Overhead Base--collects similar direct costs

Disclosure Statement--describes cost accounting structure

Indirect-Direct Cost Relationship



A lot of folks focus on the rates...

...You need to look at overall program costs

You'll have more than 1 rate--some going up, some down. And multiple segments. And lots of subcontractors.

Why didn't you give me a heads up about these rate increases?

Emphasis on Overhead Rates

No easy answers - No magic silver bullet

Overhead Rates are:

- ***Contractor specific***
- ***Location specific***
- ***Event specific***

However:

- ***Awareness of contractor's situation***
- ***Awareness of economic trends***
- ***Good communication link with ACO/DACO***

Major Drivers for Overhead Rate Changes

- ***Restructuring***
- ***Accounting Practice Changes***
- ***Changes in Business Base Projections***
- ***Labor Market Trends***
- ***IR&D Expenses***
- ***Program Problems/Issues***

The challenge is to be able to quickly assess the rough impact of these factors on individual contracts/programs.

Restructuring - Impact on Overhead Rates

Anomaly

- ***Must look at total contract/program costs***
- ***Must consider contract/program type***

Savings are both Indirect and Direct

- ***Notional example:***

Restructuring Costs - \$100M *

Restructuring Savings - \$500M *

(\$200M Indirect/\$300M Direct)

Cost/Saving Ration - 5/1

**** Amortized over a five year period***

Restructuring - Impact on Overhead Rates

	<u>Pre-Merger</u>	<u>Costs</u>	<u>Savings</u>	<u>Post-Merger</u>
<i>O/H Base</i>	<i>1,000</i>		<i>60</i>	<i>940</i>
<i>Expense Pool</i>	<i>1,200</i>	<i>20</i>	<i>40</i>	<i>1,180</i>
<i>Total Costs</i>	<i>2,200</i>	<i>20</i>	<i>100</i>	<i>2,120</i>
<i>Overhead Rate</i>	<i>120.0%</i>			<i>125.5%</i>

Bottom Line - Even though the Overhead Rate has increased, the total costs have decreased.

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